

**DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 97-0301 RST**

**Sales Tax — Mineral Oil
Tax Administration — Penalty
For Tax Periods: 1993 through 1995**

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ISSUES

I. Sales Tax — Mineral Oil

Authority: IC 6-2.5-5-30;
326 IAC 6-1-1 et. seq.

Taxpayer protests the proposed assessment of Indiana use tax on its purchase of mineral oil used for dust suppression purposes.

II. Tax Administration — Penalty

Authority: IC 6-8-10-2.1;
45 IAC 15-11-2

Taxpayer protests the imposition of a ten-percent (10%) negligence penalty.

STATEMENT OF FACTS

Taxpayer operates as a grain dealer and merchandiser. In its business, taxpayer buys and sells a variety of whole grains and soybeans. In addition, taxpayer operates a swine division where hogs are bred and sold. Taxpayer has several Indiana locations for both its swine and grain operations.

I. Sales Tax — Mineral Oil

DISCUSSION

Taxpayer takes exception to Audit's assessment of use tax on its mineral oil that is used to ensure "product integrity."

Taxpayer uses mineral oil in its grain processing facilities. Upon receipt of commodities – i.e., grains and beans – taxpayer weighs and grades the commodities for moisture content. The commodities are then dumped through a grate to an underground conveyor. However, before reaching the conveyor, the commodities (primarily corn and beans) are sprayed with mineral oil. Additionally, depending on the commodities' grade (moisture content), the commodities may be placed in grain dryers before being transported to storage.

Taxpayer argues that its mineral oil should be exempt from Indiana sales/use taxes as the oil is an integral part of its production (grain processing) process. Taxpayer characterizes its use of this oil as necessary to ensure the "product integrity" of its grain and beans. Specifically, taxpayer informs the Department that application of the mineral oil serves two essential functions. First, the mineral oil acts as a barrier preventing dust from adhering to the grain and beans. And second, application of the oil helps eliminate any dust that is already present. Taxpayer reminds the Department of the importance of dust suppression by those who handle grains and beans. Application of the mineral oil, according to taxpayer, reduces the probability of grain dust explosions in grain elevators.

Audit assessed use tax on taxpayer's purchase of mineral oil. Audit opines that production activity, for this taxpayer, begins after the oil is applied to the commodities. Consequently, application of oil for dust suppression purposes is properly characterized as a pre-production activity. And items used or consumed in pre-production activities do not qualify for exemption from Indiana sales and use taxes.

In Indiana, tangible personal property used by those engaged in manufacturing, processing, refining, mining, or agriculture is exempt from Indiana sales tax if the property is acquired to comply with environmental control statutes, regulations, or standards.

Specifically, the relevant portion of IC 6-2.5-5-30 states that "[s]ales of tangible personal property are exempt from the state gross retail tax if:"

- (1) the property constitutes, is incorporated into, or is consumed in the operation of, a device, facility, or structure predominantly used and acquired for the purpose

of complying with any state, local, or federal environmental quality statutes, regulations, or standards; and

(2) the person acquiring the property is engaged in the business of manufacturing, processing, refining, mining, or agriculture.

Taxpayer is engaged in the business of grain processing. Consequently, any determination of the applicability of IC 6-2.5-5-30 depends upon whether the mineral oil in question was acquired – and consumed – in order to comply with environmental quality statutes, regulations, or standards.

Title 326 of the Indiana Administrative Code provides for the regulation of air pollution in the state of Indiana. Article 6 of this title (326 IAC 6) limits the amount of particulate matter that a source (entity) may emit. Generally, these regulations require operators of grain elevators to comply with process emission standards (i.e., restrictions regarding particulate matter) and to engage in good housekeeping and maintenance procedures. (See 326 IAC 6-1-2.)

Specifically (for this taxpayer) Rule One (326 IAC 6-1-1) details the applicability of the Title 326. To wit:

Sources or facilities specifically listed in 326 IAC 6-1-7 shall comply with the limitations contained therein.

The aforementioned rules (326 IAC 6-1-7 et. seq.) then list taxpayer's facility (among other listed facilities) as a source of particulate emissions.

Additionally, Rule 4 of Article 6 addresses the scope of the fugitive dust emission rule. As 325 IAC 6-4-1 instructs:

This rule (326 IAC 6-4) shall apply to all sources of fugitive dust. For the purposes of this rule, "fugitive dust" means the generation of particulate matter to the extent that some portion of the material escapes beyond the property line or boundaries of the property, right-of-way, or easement on which the source is located.

Taxpayer has argued that mineral oil is applied to its grain in order to suppress, or at least mitigate, the incidence of grain dust in taxpayer's facility. Additionally, taxpayer has provided the Department with several treatises supporting the proposition that certain grades of mineral oil are, in fact, effective in reducing grain dust concentrations at grain transfer points.

The Department finds, therefore, that taxpayer's use of the mineral oil is to ensure compliance with state environmental control standards. As such, pursuant to IC 6-2.5-5-30, taxpayer's purchase of the mineral oil should have been exempt from Indiana sales tax.

FINDING

Taxpayer's protest is sustained.

II. Tax Administration — Penalty

DISCUSSION

The taxpayer protests the imposition of the ten-percent (10%) negligence penalty.

The negligence penalty imposed under IC 6-8.1-10-2.1(e) may be waived by the Department where reasonable cause for the deficiency has been shown by the taxpayer. Specifically:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-2.1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. 45 IAC 15-11-2(e).

The Department finds that since taxpayer has prevailed on a majority of the contested issues, the negligence penalty should be waived.

FINDING

Taxpayer's protest of the ten-percent (10%) negligence penalty is sustained.